

## **SME's and the Problems of Development: An Innovative Costa Rican Approach**

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*Costa Rica has developed an innovative national plan for developing existing small and medium sized firms into internationally competitive and successful exporters. This program also encourages the formation of new firms and the improvement of products and services for domestic as well as foreign consumption. The strategic approach holds lessons for other similar countries.*

### **INTRODUCTION**

In the past few decades, there has been a change on focus regarding economic development. In the aftermath of World War II and de-colonialization, the statist model of investment in large industrial projects and major infrastructure recommended such and the world community funded many of these projects; the failures of this approach to spur development and modernization led to a re-examination. Attention turned to the importance of smaller business and the necessity of exporting as sources of capital and employment. Export-led development, based on East Asian experience received much governmental and academic attention. Alternatively, or concomitantly, the role of SMEs and entrepreneurial ventures appeared to have development potential.

After nearly three decades, research generally supports political policies which:

1. promote more uniform and less onerous regulations for trade;
2. develop approaches which are segmented:
  - a. The greatest results occur from assistance to already exporting SMEs. Subsidies and trade shows are of limited permanent value in assisting non-exporters unless they have made a commitment to exporting as a major aspect of their business.
  - b. Network approaches to developing export capacity work best for non-regular or non-intensive exporters. Export success seems to be related most strongly to three factors: product fit in

the right markets, adoption of world-class process standards, and acquisition of the right type of managerial experience.

Of course, that presumes that the three conditions can be met and that intervention can help to promote the creation of those three elements. For many developing countries, existing firms largely served domestic and near neighbor markets. This did not result in products that would easily penetrate new types of markets, seldom had they created quality and process standards that were common to competing international firms, and managerial experience was limited to the types of markets already served (Naude, 2010).

In a number of countries, export promotion programs and incentives assumed that given money and exposure, their local firms could develop the requisite capacity. In all too many cases, firms ceased exporting in the absence of incentives, little product innovation resulted, and the incorporated export experience had little impact on the firms' managerial cultures (Dib, 2010; Larimo, 2007). Conversely, research into "born global" firms provided little information useful for invigorating existing firms nor as a guide for supporting new firms, in part because the majority of firms were engaged in targeted high tech (Rialp and Rialp 2007).

Concurrently, emphasis on the importance of new business creation as an engine of growth (see Autio, Kronlund, and Kovalainen, 2007 for a good summary of recent research) has also generated numerous programs in various countries, all designed to spur the formation and growth of these enterprises. While most of the research on these firms shows the advantages enjoyed by advanced economies (Moen and Servais 2002; Rialp, Rialp, Urbano, Vaillant, 2005; Zahra 2005 ), there are also such firms emerging from medium level countries such as India, Turkey and Malaysia (Yamakawa, Peng, Deeds 2008). Whether similar successes could be enjoyed with government assistance in smaller countries with fewer existing MNC advantages is a question (Wilkinson, Mattsson, Easton 2000; Autio et al 2007; Ruzzier, Hisrich, Antoncic 2006; Sriram and Mersha 2006). In addition, with limited capital and managerial experience, the focus on new firm formation in smaller, less developed countries leaves their larger domestic economy out of the development arena.

### **An Alternative Look at SMEs in a Global Trade World**

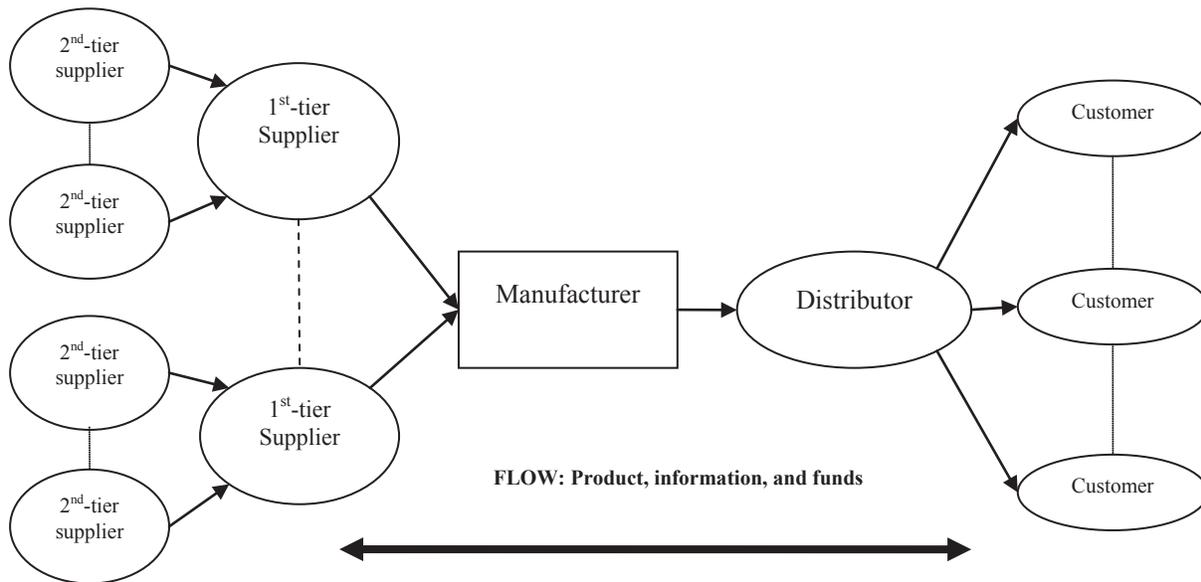
One of the efficient ways that SMEs can move into global markets and away from domestic or near regional ones is through existing supply chain systems. The keys to entering into such systems are quality product, quality service, and a record, which can satisfy supplier criteria sets.

With increasing competition across the world, companies realize the importance of suppliers as a key factor in gaining and maintaining competitive positions. Companies focus on developing strategic suppliers to reduce supply uncertainty and gain more flexibility. The process of finding and qualifying new suppliers has become more and more challenging (<http://www.supplierevaluations.com>; Chan et. al. 2008). Comparing local supplier selection to global supplier selection requires that a company consider not only cost, but also quality, delivery and long term strategy, supply chain capability and flexibility, the risk of supply chain disruption, environment, culture, reliability, as well as political factors (Chan et al. 2008; Wu and Weng, 2010; Ravindran et al. 2010). Obviously, global supplier selection increases the complexity dimensions of such criteria.

The typical supply chain can be figuratively described in Figure 1, with a linked group of suppliers creating products ultimately sold to consumers.

Supplier selection and evaluation are major activities of the supply chain. Bring qualified new suppliers to join the existing ones will improve total supply chain performance and thus add the value to supply chain partners. Ho et al. (2010) reviewed the research literature on multi-criteria decision making approaches for supplier evaluation and selection between 2000 and 2008 and classified the methodologies and suitable applications. They reported that multi-criteria decision approaches are better than traditional cost-based approaches.

**FIGURE 1**  
**THE SUPPLY CHAIN: CONTEMPORARY NETWORKS**



Although existing methodologies can help companies to evaluate and select ideal suppliers based on, their specific requirements, in reality, companies often find acquiring high quality and adequate data from a potential supplier's region/country a big challenge. Some developing countries lack public data for their enterprises, especially SMEs. Furthermore, companies realize that managing and monitoring global suppliers is difficult because of culture, distance, and infrastructure factors far beyond the control of local supplier managers. When companies have no subsidiary or other facility in a supplier's country, their supplier's activity is opaque at best. Thus, high risk and instability may enter an existing supply chain by way of supplier base expansion. This limits the chances of SMEs from these countries to become regular suppliers to large multinational firms.

In the past few decades, some developing countries have received significant economic growth both internally and from exporting, but most developing countries are still struggling to achieve either, needing to strengthen management capacity, and encourage entrepreneurial activities. The common situations faced by developing countries are low capital resources, often heavy bureaucracy, and commodity or old technology product bases. These are limiting factors in their efforts to achieve either FDI or export growth.

On the other hand, there are also possibilities for developing countries stemming from location advantages, cheap raw materials, low-labor cost, local products transformation, etc. Whether these advantages can be used to reach greater economic growth is the challenge.

In terms of global market development, developing countries should focus on not only industrialized countries but also fellow developing countries. UNCTAD (2008) indicated that South-South trade has more than tripled between 1996 and 2006, reaching a total of more than US\$2 trillion, showing that this potential is being realized by some. The report further pointed out that south-south trade encourages the creation and growths of SMEs who find it feasible to trade with similar firms and engage in regional competition that they understand.

In the global economy, SMEs play a key role in both developed and developing countries. MSS research (2010) reported that China created 101 million jobs between 1985 and 1991, 70 per cent in 'township and village enterprises', of which nearly half are privately owned. Many strategies to promote SMEs are arising in developing countries such as creating stable macroeconomic environment, providing

strong support for product exporting and raw materials importing, streamlining bureaucratic procedures to improve efficiency of business processes, emphasizing training and technology support, etc. Industrialized countries are also continuing to promote SMEs business. For example, the U.S. government provides more support small business by providing new tax-breaks, increasing small business administration (SBA) lending limits. This effort to promote SME creation as a development solution, however, has proven uneven in its effectiveness. Most SMEs show little expansive growth; although a major source of employment, employees per firm remain low. Lack of capital and research limits product development, with many offering services or products geared at local markets (Naude, 2010).

The reported research in this paper examines the recent history of export development and intervention policies in Costa Rica, providing a snapshot of past failures and investigating an innovative new program that is successfully supporting SME development with a strong export focus. Costa Rica is building on their strategic advantages and planning economic support with a clear understanding of the role that supply chain plays in current global trade. This time, unlike in past world trade recessions, Costa Rica is surviving well. Unemployment increased from 5.6% in 2008 to 7.8% in 2009, but fell back down to 6.4% midway through 2010. Although GDP contracted in 2009, its fall was below the world average decline for developing economies and is rebounding in 2010, with an expected 4.5% GDP growth (Badawy, Reuters, September 21, 2010). Industry now accounts for 22% of the economy (official Costa Rica government puts that figure at 32% cf. Badawy op cit) and agriculture only 14%, a distinct reversal from the past. Its exports are to a mix of both industrialized and developing, regional countries. (CIA Factbook, 2010). This is a markedly better result than the serious impact of the 2000-2001 recession that saw unemployment spike at around 10% and exports fall dramatically. Some of this must be attributed to the combination of smart Enterprise Development Zones (EDZ) and diversification and creation of value-added manufacturing utilized by Costa Rica in the past decade.

### **Costa Rica Background**

Traditional Costa Rica was a producer and exporter of the usual Central American goods, primarily coffee and bananas. Around those products grew some small businesses providing containers, transport, and other small services. Costa Rica first ventured out of the traditional pattern with its aggressive campaign to protect the ecosystems and special habitats found there, funding those efforts by using it as a tourism attraction, creating non-farming jobs and bringing in foreign earnings.

With support from outside sources, particularly the US development agencies, bankers, industrialists, and top economists in Costa Rica joined to form CINDE (Coalición Costarricense de Iniciativas para el Desarrollo) in the 1980s. CINDE actively promoted legal and regulatory changes in Costa Rica in order to create incentives for foreign investment and support for local firm export efforts. Along with the policy changes, they created a first system of technical assistance and training to encourage development of non-traditional agricultural exports and upgrade managerial expertise sufficient to run these new ventures and interact with non-domestic firms.

To implement this program, Costa Rica chose to invest in the textile industry, as did many other developing countries at the time. Initial results were very successful: within 10 years, export value went from \$90 million to \$781 million, 146 new foreign investment projects resulted and 18,000 new jobs from FDI, 55% in textiles (Clark 1995). This growth would not continue, given three changes of major import: the end of US AID to underwrite the training and technical assistance programs, a change in CINDE away from lobbying and political reform, and the tsunami of Chinese textile exports that eventually eliminated much of the developing world's textile export regimes.

The coalition developed during this growth period, however, demonstrated that a SME/FDI/export oriented program could be sustainable if it were based on a strategic plan utilizing specific country advantages and a differentiated capacity building initiative.

Costa Rica had a small number of firms that were active and experienced exporters. There was a well-educated workforce, although not necessarily trained for international management or production. They had a well-functioning state and a cohesive population. The transportation infrastructure was well-developed from years of commodity exporting. On the weakness side, it is a small country with limited

capital. The existing industries were low technology and based on support for the agricultural base. The export oriented firms tended to cluster in the commodity area or engaged in trade with similar Central American countries.

The new initiatives were designed to create an industrial base oriented toward growth industries not easily replicable by similarly situated countries. First, the FDI program was re-oriented to attract leading, high research oriented firms. Specifically targeted industries were computer related, pharmaceuticals, and specialty chemicals. A combination of incentives, including extensive industrial parks, free trade zones, and tax advantages attracted large firms and the first firms made the situation attractive for others, including companies from other industries. The stability and relative affluence in Costa Rica also made it an attractive sales and distribution center for central and northern South America.

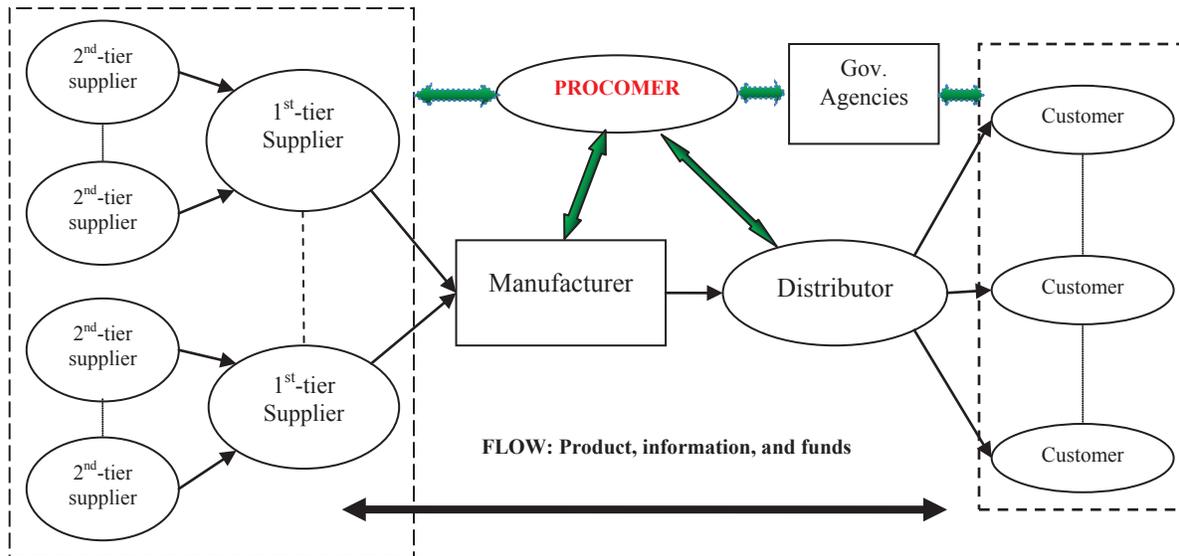
Second, the foreign investors were encouraged to use Costa Rican firms where possible as suppliers of services and goods. There were a few firms already active in international trade that formed a base of expertise. PROCOMER (Promotora de Comercio Exterior de Costa Rica) recognized the need to develop and expand programs that could promote supply partnerships and to encourage the creation of a variety of products and services beyond the ones already in place. Thus, PROCOMER was designed to link existing and new firms in Costa Rica to these investing firms while also encouraging the improvement of existing firms in other industry sectors.

With this idea of expansion in mind, PROCOMER consulted with large and small firms to develop key business development partnerships in various areas in the targeted industrial sectors. The studies that PROCOMER included in its agenda included an analysis of the economy in different parts of the world and how Costa Rica was placed in the context of economic development both in the Americas and around the world. Studies were also conducted into exports with reference to its products according to level of production including agricultural, textiles, cattle and fishing sectors, the level of exports per product, the regions best suited for export to, number and size of companies, and mode of transportation. Weaknesses in infrastructure, training, and skills were a central focus along with identification of factors that would support and encourage economic expansion.

CADEXCO (Cámara de Exportadores de Costa Rica) then became the promotion and training arm for Costa Rican firms already engaged in export activities, although many of those firms also work within the PROCOMER umbrella as mentors. Currently, PROCOMER is quasi-governmental organization promoting diversity in exports, advising and training members on productivity and quality, and encouraging regional integration through the exchange of products among industries and people. In addition to its work in promoting FDI and supporting the common export policies of CADEXCO, new programs have emerged.

Its most innovative aspect is the creation of a sort of matchmaking service between international firms and Costa Rican firms. Focusing on the importance of supply chain in modern global business, it creates programming to develop, encourage and support the movement of Costa Rican firms into these groups. Firms wishing to expand and grow are signed into the development program. New firms, locating in industrial parks are required to use their services. This program includes education, training, evaluation, mentorships, and contacts. PROCOMER will even assist with supply chain contract negotiations as a neutral third party and monitor the parties for three years, providing counsel and mediation as needed ([www.procomer.com](http://www.procomer.com); personal interviews with the Director). Directories of Costa Rican suppliers are provided as are constantly updated possible purchase inquiries. PROCOMER has achieved a high level of trust with both Costa Rican firms and foreign firms. Firms, which have “graduated” into successful and independent world-class suppliers, are then used as trainers and mentors for other firms. All are encouraged to use their experience to expand into new markets and create new supply customers. Figure 2 shows the innovative role of PROCOMER in the traditional supply chain.

**FIGURE 2  
SUPPLY CHAIN WITH PROCOMER INVOLVEMENT**



**RESEARCH APPROACH**

We conducted in-depth interviews with a number of Costa Rican firms involved in these efforts; six are reported here as both typical and representative of different stages and roles in this initiative. Table 1 is the summary of role, industry, and type of these six firms. We had developed a fairly simple model for our questions, based on research into SME, not Born Global, results in export development and used that as a basis for the interviews. We were interested in exploring the extent to which these new public/private initiatives were perceived as helpful and the extent to which firms took advantage of the program. We were especially interested to discover whether the new relationships had:

1. resulted in long-term supply contracts or relationships;
2. led to new product or service creation;
3. encouraged expansion into new markets and new purchasers.

In this research, we avoided interviews with software firms, although a successful sector for Costa Rica, as they were largely not involved in the government project and more likely to be directly connected with MNCs. These firms would be interesting as a separate project.

**TABLE 1  
ROLE, INDUSTRY, AND TYPE OF INTERVIEWED FIRMS**

<b>Role</b>	<b>Industry</b>	<b>Type</b>
Participant	Containers-metal	Expanding
Mentor	Containers-glass	Established
Mentor, networker	Printing	Established/Expanding
Participant, networker	Containers--paper	Expanding
Participant	Specialty electronics	Early growth
Participant	Stone, ceramics	Expanding

## RESULTS AND DISCUSSIONS

We are reporting in this paper primarily on six of the firms, chosen as representative of different stages and roles in the supply chain initiative: a mixture of mentoring firms, emerging firms, and new firms.

The interviewees all confirmed the importance of the new initiatives in their general development. Most had maintained their original supplier contracts and generated new ones. They spontaneously cited the movement into new products and value added services as the key result—they felt they now had a secure base and were no longer simply low cost commodity providers. The older firms all had acquired ISO certification while all but one of the newer ones was in the process of doing so.

We specified several factors relating to product, services, and management in SMEs that previous research (Solberg 2006) had identified as highly related to successful expansion and profitability in export markets. Of particular interest were the following possibilities.

**1. *Were these firms more likely to focus on value-added services and product adaptability rather than high technology per se?***

Although there are a small number of firms in areas considered high technology, these firms are not enrolled in the PROCOMER program. Like many of the “Born Globals”, they directly entered the international marketplace because the market for most of those goods and services are international. The firms in the PROCOMER program utilize a great deal of technology and acquire additional capacity as they grow into their supplier roles. However, the focus of the firms, at the urging of their coaches and mentors, is the development of product added value design and services. For example, the glass and container makers emphasized that they were retaining and gaining supply contracts based on their ability to quickly design and manufacture specialty products. One of the firms indicated that they now pro-actively pre-design products they think would appeal to certain firms and then sell those new products in order to gain supply contracts. The printing company has been able to greatly expand their market and become the label supplier to, among others, Gerber because they promise mistake proof labeling and brochures in every written language.

**2. *Were these firms more likely to adopt newer technologies in the production and improvement of existing products?***

Firms actively engaged in serving international markets, defined here as those beyond the near Central American countries, are investing in newer technologies and equipment as necessary to meet product and quality standards. They are also, when capital is available, investing in equipment in order to achieve higher productivity and cost savings. It is well-recognized by participating firms that simply being a low cost producer is insufficient, but that high costs/low productivity will not save even high quality products at the level of today’s international competitors. One firm indicated that the advisers from PROCOMER had assisted them in making capital-spending decisions and in locating a supplier who provided financing.

**3. *Were these firms making efforts to reduce cultural distance, defined as both country cultural and managerially (e.g. global standard vs. regional standards)?***

Traditionally, Costa Rica largely exported commodity agricultural products, and then, later, textiles. Products associated with those commodities were often exported to surrounding countries that largely produced the same goods. Today they still actively export to those countries, both traditional and newer products, quite successfully. However, it is recognized that all these countries have small markets and the regional limit is insufficient to support growth and development. The expansion out of the regional market differs for each firm we interviewed. Some have expanded the idea of region to include Mexico and Northern South America. Others look to the US, Canada and the Caribbean basin, while several are now truly global in their

markets. In addition, they understand that in some cases they are essentially indirect exporters - that is, they sell to a singular multinational, possibly based in Costa Rica, but their products/services are used in the multinational's global market. Two firms expressed intentions to build on that to create opportunities directly in other, more distant countries directly. As the number of firms "graduating" from the PROCOMER development system increase, the use of trade missions and subsidized trade fairs will increase. As one Principle explained to us, "only the first contract is hard to get. Keeping them and increasing to depend more on my skills and those of my employees. We all have to be globally minded."

**4. *Were these firms more likely to form value chain networks with other Costa Rican firms in attempting to integrate into larger supply chains or direct export?***

This is true, in part, because of the coordination efforts to boost small business development and exports. It is also the case that many of the firms, each highly specialized, had worked together in both domestic and export business for several decades. What have changed are two things. First, new firms are cooperating with other Costa Rican firms in forming sub-networks within the supply chain system. Second, existing cooperative arrangements are leading to the necessary improvement of Costa Rican firms as they find they must meet the new standards for quality, timeliness, technology integration, etc. If they do not, their customer will have to find another. In addition, makers of complementary goods are also working together, e.g. carton makers with foam makers, etc. Since most of the firms are small, they tend to work together in approaching and servicing large international firms. As they individually start finding contracts and potential customers, these are somewhat shared within the groupings.

**5. *Were these firms would differ on their ability to leverage experience with MNCs into additional supply relationships?***

As firms gain both experience and a sales base with the training and mentoring of PROCOMER, they change their internal management focus. The newly engaged firms reported that they had to change their internal mindsets and procedures, but the result made them both eager and capable of seeking out additional business and/or expanding to new regions. They were also now participating in trade fairs and subscribing to lists asking for bids and quotes. Few had engaged in any of these activities previously, and none of the firms listed above as in the development program had done so.

PROCOMER is finding that some firms exhibit far greater readiness to embrace the new approach than others do. The director said that this mindset was the most important key to assisting the firm and seeing success. On the other hand, to many of these family owned firms, too much growth is perceived as deleterious to the scale and control of their firms. For these firms, a few high quality customers were important, but they had little interest in pursuing additional ones.

**6. *Were these firms more likely to find business networks important in development of their firms and their export capabilities than personal networks?***

Although the mentoring firms had expanded their vision beyond Costa Rica and, therefore, had a set of business contacts that were larger and less personal, the majority of Costa Rican firms are still culturally attuned to personal relationships and slow to commit to business relationships as, for example, Americans would see them. For this reason, many reported a greater comfort level in expanding within Latin America rather than more culturally diverse regions of the world.

They were more likely to seek advice and comment from a close set of business contacts that were also closely connected in personal ways. The small size of the country and its managerial elite would tend to support and reinforce these tendencies as well. Also, the disasters of the textile and generalized export promotion policies of the past inhibits them from seeing these business networks as useful or secure in the way that the personal tie business networks appear to them.

## IMPLICATIONS AND CONCLUSIONS

This brief snapshot of the PROCOMER program and the hypotheses drawn from interviews with participants (and the literature on successful exporting/supply chain participation) obviously has its limitations. The particular emphasis and direction of PROCOMER grew out of a particular set of strengths and history. Other countries may develop different programs based on their own unique set of environmental conditions. However, the careful training, mentoring, and entrance into global markets through supply contracts with multinationals, especially those based in Costa Rica are potentially a good model for other small countries.

Too often, small countries that rely heavily on commodity exports fail to develop effective small firms, grow larger firms, or recognize the importance of supportive government efforts. In particular, the governmental effort to target a category rather than a set of favored firms was significantly important in gaining trust and participation. That in turn led to a broad base of firms entering into international markets with differentiated products and the acquisition of a “learning firm” mentality.

The decision to focus initially on three industries for FDI and the follow-up in designing the PROCOMER supply chain program was important also. It is far more difficult, as PROCOMER is now finding, to guide firms whose customers are acting within a wide range of industries. Understanding the dynamics and competitive base of an industry allows the government trainers and firm mentors to provide more detailed and actionable information. The immediacy of the training and support pushes participating firms to continue. Less specificity and immediacy tends to create a larger number of dissatisfied participants and higher dropout rates.

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