

## **Ease of Doing Business by SMEs in Papua New Guinea: The Factors that matter**

### *Non-technical summary*

By Ludwig Aur Aba<sup>1</sup>

The Small and Medium-Enterprises (SME's) are key drivers of economic growth and development in many small developing countries. For example, in Malaysia, the SME's contribute about 50.0 percent to GDP, as well as contribute sizably to exports and employment. In South Africa, the SME sector constitutes about 35.0 percent of GDP and generates about 50.0-60.0 percent of the total workforce. In PNG, it is estimated that SME's contribute about less than 20.0 percent of GDP and contribute significantly in provision of jobs and income for households. Given the importance of the SME sector to PNG economy, it is critical that factors hindering its progress is identified and addressed to create a conducive environment for growth.

Studies related to the state of SME's and, more specifically, factors that hinder growth of SME's is scarce in PNG and the Pacific Island Countries (PICs). Few recent literatures from this region have pointed to remoteness of business location, limited land access, difficulty in accessing bank credit, poor infrastructure, low impact investment and high borrowing cost as factors impacting growth and expansion of SMEs in the Pacific region including PNG. A United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) report identified four critical factors that are integral to the growth of SMEs. These include a reduction of barriers to entry (and related costs) for new businesses, adequate SME cash flows and, entrepreneurship capacity building through education and training, and the effective networking and information dissemination. An SME Business Survey Report by Pacific Enterprise Development Center (PEDF) (2003) highlighted several critical factors to SME growth including access to capital, regulatory improvement and enforcement, direct assistance, sector segregation, and willingness to participate in business association.

SME development and growth is largely dependent on the enabling business environment. Ease of doing business is a fundamental enabler and cornerstone of any business survival and growth. This is especially true for the SME's which are small in size with limited capacity to expand. As a contribution to these existing literature on the SME growth and development in PNG, this study attempts to establish factors that influence ease of doing business in PNG. Specifically, it focuses on identifying the key factors and their marginal effects on the probability of the ease of doing business by SMEs in specific economic sector and by doing so estimate the size of the impact on each industry in response to a change in the factors.

As part of this analysis, the Bank of PNG conducted a comprehensive Business Pulse survey to assess the existing operations of the SMEs, and to identify the specific factors that affect the ease of doing business. The survey covered 1763 SMEs from 21 different economic sectors, in 13 provinces in PNG. Using the survey data, the study estimated the average marginal effect of the factors impacting ease of doing business using a Probit econometric model.

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<sup>1</sup> Author is the Manager at the Research Projects Unit, Research Department of the Bank of Papua New Guinea. He can be reached through [LAba@bankpng.gov.pg](mailto:LAba@bankpng.gov.pg)

## **Conclusion and policy implications**

The study established that access to government services, strong law and order, adequate provision of physical infrastructures, effective Government regulations, increased access to credit and financial support, increased cross-border trading and effective contract enforcement are key factors that could propel SME growth in PNG. The study also found that the size of the impact of each factor on the economic sectors varied, confirming that some of these factors are industry-specific while others cross-cut across all industries.

Most existing recommendations for policy reforms are based on the one-size-fits-all assumption. Although this may be true for some factors, this finding revealed that different sectors face industry-specific challenges, hence, any policy reforms should be designed from industry perspective. For example, the study established that most SMEs in the Agriculture/Forestry/Fishery, Information and Communication, and Retail and Wholesale sectors are constrained from growth and expansion due to lack of financial resources and capital. Given this, the Government and key stakeholders should design policy reforms that can address this impediment to promote growth in these industries. In another example, the finding revealed that SMEs in Agriculture/Forestry/Fishery, Accommodation and Food Service Activity, Administrative and Support Services Activity, Building and Construction, and Retail and Wholesale sectors face challenges relating to enforcement of contracts. The government could introduce important regulations, policies and laws that could assist to address this limitation. This indicate that each sector is affected differently in varying degrees and appropriate policies should be designed to address industry specific challenge.